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A Preview of Clintonomics

by Murray Weidenbaum

A new cottage industry has quickly developed in the United States: forecasting the changes that will be made by President-elect Bill Clinton when he enters the Oval Office on January 20, 1993. Judging by the gap between initial promises and ultimate performance in the case of every recent president, we can only guess which campaign promises will be carried out and what the effect will be on the American economy. Nevertheless, having been asked to undertake this assignment, I will try. Surely, a new president and one from a different party inevitably will bring about important changes in national policy and in public attitudes.

It is useful to start with a baseline — an overview of the American economy. Most professional forecasters expect that the economy will be stronger in 1993 than this year — whether or not any new policies are introduced. Economic growth in 1993 is now expected to get close to 3 percent, compared to less than 2 percent this year. That's not a candidate for the Guinness Book of World Records, but it is an improvement. The fact that the upturn is baked in the cake, so to speak, won't prevent then President Clinton from claiming credit for it. But we should not be too hard on him. If the roles were reversed, a Republican successor would crow that the economy was growing more rapidly since he took office.

A cynic would say that, now that the election campaign is over, it is no longer fashionable to lament the weak economy. It's OK to admit that consumer outlays rose at almost a 4 percent rate in the third quarter of 1992, that exports have risen by more than 7 percent in 1992 to date, that housing is up more than 15 percent over last year, and that the unemployment rate dropped a bit in the last quarter.

President-elect Clinton is likely to enjoy an extended economic honeymoon. Given the

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large amount of slack in the economics of the United States and most of our major trading partners, any new round of inflation will probably be very slow in developing (the other side of that proposition is that, once inflation gets going, it is painful to bring it down).

Clintonomics

The general dimensions of the changes that we can expect in the next four years seem to be fairly clear. The Clinton Administration will promote a far more activist government role in the economy. It likely will begin during a dramatic first 100 days (or maybe 200 — despite the advances of technology, it may take longer nowadays). During that time, a revised version of George Bush's last "swan song" budget will be developed and presented to the public.

The announcement of a new and young political team in the White House with an ambitious program should help to generate renewal of consumer confidence and, to some extent, even business confidence. Also, the delayed effect of the monetary easing by the Federal Reserve over the past year will stimulate economic activity. To some extent, Americans have held off buying "big ticket items," such as automobiles, appliances, and home furnishings — and especially new homes. With less uncertainty at least in the political sphere, consumers may begin to open their wallets and purses once again. Simultaneously, and despite philosophical misgivings, many in the business community will also welcome the renewal of the now restrained governmental customer.

Let us focus on the key economic and business actions that are likely to take place in the early years of the Clinton Administration.

Infrastructure

Federal public works will be expanded substantially. Governor Clinton has promised to create a Rebuild America Fund to finance a variety of infrastructure projects and to jump start a slow-growing economy. This variation of an old-fashioned jobs program covers far more than merely repairing roads and bridges. He wants to create a high-speed rail network

linking major cities and commercial hubs, to develop "smart" highway technology, to build a national information network, to generate new energy sources, and to create advanced recycling systems. It is unlikely that he will be able to move on all of these fronts at once. But we can expect that his administration will make the effort in the case of many of them. The growing availability of scientists and engineers laid off by defense contractors constitutes a great pressure to utilize this valuable resource through the types of federally initiated programs proposed by the President-elect.

How will the ambitious array of infrastructure projects be financed in a period of continuing large budget deficits? President-elect Clinton proposes to tap private and state and local pension funds. But these funds are already invested. Thus, if he succeeds, this will mean a diversion of investment capital from business in the private sector to government agencies in the public sector. Sooner or later, the resultant competition for funds will push up interest rates, especially on the longer maturities typically used to finance capital improvements.

Tax Proposals

The Clinton Administration likely will try to carry through on some of the many tax proposals that were surfaced during the campaign. These range from lowering the burden on the middle class to making the rich pay their "fair share" of taxes to providing a targeted investment tax credit. The latter would be a fundamental departure from the approach introduced in the Kennedy Administration and applied frequently since: traditionally the taxpaying business decides where to put its investment funds, with the government assuming a very minor part of the risk. A targeted credit, in contrast, means that the federal government will choose the specific investment categories that qualify. The ability to pick sensible economic targets is not a highly visible characteristic of the American political process. But that shortcoming rarely inhibits governmental decisionmakers.

The Governor's tax program includes a 50 percent tax exclusion for entrepreneurs,

making the R&D tax credit permanent, and expanding the earned income credit. Of all these proposals, increasing the tax burden on the high-saving upper bracket taxpayers is most likely — with negative consequences on private investment. This whole approach is based on the implicit assumption that rich people dodge the tax collector because they can hire high-priced lawyers and accountants to find them loopholes to shelter their income from taxation. Of course, some folks do just that.

Yet, the overall numbers are an eye opener. The households in the top fifth of the income distribution pay out about 27 percent of their incomes in federal taxes, the households in the middle fifth pay 20 percent of their income in federal taxes, and the bottom fifth pay only 9 percent of their income in federal taxes. A full third of all federal tax payments is collected from the top 5 percent of households. Such data should stop the demagogues, but it rarely does.

The odds are that members of the Congress in both parties will initiate serious discussions on a consumption tax in 1993. However, the dominant proposal is not likely to be a new national sales levy, such as a European style value-added tax. Rather, interest is rising in changing the present income tax to exempt all saving. In effect, it would be the equivalent of adopting a universal IRA without all of the restrictions and costly paperwork now required. The result could be as progressive a rate structure as at present, but with more incentive for saving and investment and thus make more likely a faster rate of economic growth and job creation.

Health Care Reform

Health care costs will continue to rise. It is useful to keep in mind the results of a brand new Congressional Budget Office study. On the basis of merely continuing current policy, CBO expects that health care outlays in the United States will rise from 12 percent of the economy in 1990 to 18 percent in the year 2000.

Mr. Clinton is not satisfied with the status quo. He wants to guarantee every

American quality health care. His "core" package includes hospital care, physician services, prescription drugs, prenatal care, mental health, mammograms, and routine screening. He also advocates expanding medicare to cover long-term care. All that is bound to be very expensive.

His response is to establish new health agencies, including a national health standards board and local health networks. The board is to be charged with establishing health budget targets and determining the specific nature of the package of core benefits that is to be made available to every American. The unwieldy board, which will replace the existing Health Care Financing Administration in the Department of Health and Human Services, will be made up of consumers, health care providers, business, labor, and government officials. He also envisions a variety of local health networks made up of hospitals, clinics, doctors, and insurers. Like the present health management organizations (HMOs), each network will receive a fixed amount of money for each consumer. That is expected to give them the necessary incentive to control costs.

Every employer is to be required either to buy private health insurance for its employees or to pay into a public fund created for the purpose. Every American not covered by an employer is to receive the core benefits package. There is no indication who will pay for that.

Education

Education costs will increase more rapidly. Governor Clinton's plans to "overhaul" the public schools include establishing tough education standards, setting up a national examination system, reducing class sizes, and providing money for school security and metal detectors. Mr. Clinton also wants to set up a National Service Trust fund to loan money to every American who wants to go to college. For those who do not go on to college, he intends to set up a Youth Opportunity Corps and establish a national apprenticeship system. He promises each graduate "a good job" — that's one of those campaign pledges that is likely to dissolve before Inauguration Day. He also promises to require every employer to spend 1.5

percent of payroll for education and training. That's easier. Increasingly popular off-budget mandates on business are a key example of the proposition that it's a lot of fun to try to do good with other people's money.

Social Programs

Social welfare outlays will grow, at least initially. President-elect Clinton advocates fully funding Head Start, the infants and children program, and all of the initiatives proposed by the National Commission on Children. He also wants to give people on welfare education and child care — in an effort to wean them off public support eventually. In addition, he promises to start a national deadbeat databank as a means of cracking down on parents that don't support their children. He also wants to use IRS to collect child support from recalcitrant parents. As a Treasury alumnus, I have great confidence in the ability of the IRS. But I have to point out that, in the absence of a major budget increase, new responsibilities are performed at the expense of existing activities such as tax collection.

Housing and Urban Development

The government's role in housing and urban development will increase. Governor Clinton's plans include government funding of low-income housing, the prevention of redlining, and creating a network of community development banks. The latter sounds suspiciously like the original justification for the now-failed savings-and-loan associations. Governor Clinton also endorses the notion of enterprise zones.

Regulation

Regulation of business will be on a growth trajectory. The environmental area, championed by Vice President-elect Al Gore, is a natural for accelerated expansion. Several other, more specific areas have been singled out for tougher regulation — including health care, insurance, and pharmaceutical companies. I'll get back to that a little later.

State and Local Relations

The federal government will enter areas of activity traditionally reserved to state and local governments and to the private sector. For example, Governor Clinton promises to create a National Police Corps. He also has pledged to put 100,000 new police officers on the street and to establish boot camps for first offenders. He wants to fund more drug treatment. Much of this activity is likely to wind up being administered by state or local governments. Privatization, in contrast, seems to be considered a form of pornography by the Clintonites and discussion of this topic has been dropped from polite public discourse. The Clinton program also includes a new agency to develop "cutting-edge products." Presumably, he means more than just lawnmowers.

Defense Conversion

The defense budget will be cut much more than now planned, but the federal government will be more heavily involved in the activities of defense companies. Thus, candidate Clinton proposed a new program of loans and grants to help defense companies convert to civilian pursuits. His infrastructure programs specify the use of defense production facilities. He also wants to develop an inventory of national defense jobs. Given the past inability of defense contractors, especially the larger firms, to use their capabilities in civilian markets, this initiative is likely to generate into another inefficient handout program. Of course, we'll have to get used to the newest euphemism for federal subsidy — "high priority government investment."

But history tells us that, early in a new presidential administration, it is likely that one or more hostile nations will try to rattle our cage, to test the resolve of the newly inaugurated chief executive. Several regional powers may attempt to reassess their ability to throw their military weight around — countries such as Iran, Iraq, North Korea, or China. Such "scares," at least in the past, have exerted a sudden and often unanticipated upward push on the military budget.

Famine in Africa reflects the social and political instability in many regions. The

image of the heavily armed republics of the former Soviet Union conjures up other potential threats of military action. So do terrorist groups active on every continent.

Foreign Trade Policy

While President-elect Clinton's overall position on international trade tends to lean against the protectionist sentiments, the balance of the new Congress is likely to be in the opposite direction. Thus, at the margin, I would expect more regulation of imports and foreign investment (including U.S. overseas investment) than under President Bush. But, as in every recent presidential administration, the formulation of trade policy will be a continual tug-of-war between the White House representing broader national interests (this means more open markets) and the Congress representing narrower interests that often advocate protection against competition, be it foreign or domestic.

The odds favor that, sooner or later, the North American Free Trade Agreement (NAFTA) will be approved by the Congress — perhaps after some modifications in the form of accompanying legislation on labor and environmental matters. The necessary shove for a reluctant Congress will come in the form of the growing realization that Mexico is becoming a key customer for American products. After all, when American-owned firms locate low-tech, low-cost factories in the Orient, they increase the income of local consumers who buy products largely made in the Asian rim countries, especially Japan, South Korea, and Taiwan. In striking contrast, U.S. factories located in Mexico generate wealthier customers who mainly buy U.S.-produced goods and services. The numbers are clear on this score. Mexico is displacing Japan as our second-best customer. Canada, of course, remains the largest market for U.S. exports.

By the way, this tendency to trade mainly with your close neighbors is not unique to North America. Since the formation of the European Community, the Western European nations have shifted their trading patterns to favor EC nations. Although there is no formal counterpart in the Asian rim, the same tendency is visible in the patterns of commerce in that

part of the world. Seen in this global light, NAFTA is a rather natural response in this part of the world.

However, it is discouraging to note that the chairman of the U.S. International Trade Commission urges "supplementing" the North American Free Trade Agreement with "a new earmarked source of funding" to cover the large costs of meeting environmental, infrastructure, and education and retraining costs in the border areas and elsewhere. To paraphrase the gentleman, "I'm all for free trade, but . . ."

Other Proposals

Governor Clinton also has some specific suggestions governing political campaigns and lobbying. Thus, he wants to toughen lobbying disclosures and lower the cost of air time for political campaigns. Presumably, he means lowering the price charged candidates because he has little ability to really lower the cost of television and radio operations. This means that somebody will have to subsidize this new benefit, either the government or the radio and television industries, or both.

In *Putting People First*, Mr. Clinton offers one innovation that has all the earmarks of a half-baked idea that nobody in the campaign thought through: to require every person and organization that "contacts" a federal official, a member of Congress, or an aide to report on a form designated by the U.S. Office of Government Ethics. No exceptions are made.

If you take the proposal seriously — which I don't — every old friend who says hello to a federal official, on or off the job, will have to fill out a report. Of course, that's just an illustration of the fact that not all campaign promises are taken seriously.

Government Regulation of Business

There is one area of prospective change that is worthy of more detailed consideration because it has been ignored in virtually all of the debates — the ever more rapid expansion in government regulation of business that has been taking place in recent years. The fundamental

basis for the acceleration of an already rising trend is the widespread public belief — fanned by partisan political charges — that the Bush Administration cut back on regulation of business, especially in the environmental area.

Yes, it is true that, on occasion, President Bush and, especially Vice President Quayle, delayed or caused to be modified some of the most costly and inefficient regulations that were proposed by the federal regulators. But every president since Gerald Ford, and that includes Jimmy Carter, has found the need to set up a regulatory review mechanism in the White House.

Nevertheless, the underlying trend is clear: federal regulation, especially environmental regulation, accelerated during the past four years. That is true any way that you measure it — by the number of regulators, by the budgets of the federal regulatory agencies, by the number of pages in that bible of regulation, *The Federal Register*, or by the cost of compliance in the private sector.

It is ironic that, during the Earth Summit in Rio last June, the nations that criticized the U.S. position had much weaker environmental laws and enforcement procedures and devoted smaller shares of their economy (e.g., gross domestic product or GDP) on environmental cleanup than we do. In automobile regulation, for example, the big debate among the Europeans is whether they will ever match tougher U.S. standards. Even if they eventually do, there will be many years of delay on their part.

Nevertheless, there is every indication that the Clinton Administration will accelerate the growth of environmental and other regulation in the United States. Congress is already working on more costly and stringent versions of the Clean Water Act and the Resources Conservation and Recovery Act as well as a greatly expanded version of the Occupational Safety and Health Administration (OSHA) legislation. The latter includes giving individual employees "shut down" authority if they claim the presence of a safety problem. Picture the consequences during any labor-management dispute.

But the Clinton program also envisions going after new regulatory targets, such as

insurance companies, which he assigns major blame for high health care costs. In his widely distributed *Putting People First* statement, however, he states that every health insurance company should be required to take all comers, regardless of the seriousness of any preexisting conditions. It is hard to see how that will slow down the rise of medical expenditures. Moreover, each business in a given locality, regardless of size and type of activity, is to pay a set amount for each person it employs. The inevitable result will be that workers in low-risk industries will subsidize those in high-risk activities. Those who follow a healthy life style will pay for those who don't. Insurance incentives will clearly become perverse.

Pharmaceutical firms are another target for the Clinton regulators. Ironically, this is one of the few industries in which U.S. companies maintain a world lead and year in, year out, generate a substantial excess of exports over imports. It is also one of the very few manufacturing industries that increased its work force during the 1980s. As you might suspect for a successful, expanding industry with a very rapid rate of product innovation, profits are high. The Clinton program responds by calling for "cracking down" on drug manufacturers and eliminating some of their tax incentives.

This is one part of the Clinton regulatory agenda which should be taken seriously because of the sentiment among some members of the Congress to curb prices on prescription medicine. In one recent floor debate, a senator exclaimed, "It is hard to believe that such a company could charge so much for such a tiny pill." I am tempted to make some comment about some of the tiny intellects that serve in what the members call the world's greatest deliberative body.

In addition, the entire medical industry is a target for detailed supervision. We are bound to see a great deal of thrashing about on the part of frustrated regulators and those burdened by regulation when the promised objectives of lower costs and higher quality are not achieved. But no combination of Newtons, Einsteins, and Hercules would be equal to that task.

The Economy Next Year

The American economy has been rocking along the bottom for well over a year as it continues its convalescence from the end of the Cold War. After repeated injections of easier money by the Federal Reserve, all that we have learned is that our economy has a big bottom. The upturn finally seems to be here. But it is unusually slow. You need a microscope to spot it. But there's a silver lining. A sluggish upturn does not generate much inflation or a rapid rise in interest rates. Therefore, this recovery may be long lasting. That is also a conservative economist's way of saying that a Clinton Administration will not be the end of the world.

It is sobering to note that some veteran economic forecasters expect the same number of new jobs to be created in the American economy over the next four years — 8 million — whether or not the Clinton economic program is adopted. Likewise, they anticipate the same 50 percent reduction in the size of the annual budget deficit promised by Mr. Clinton to occur in the absence of his program. The anticipated normal growth of the economy is expected to be the key positive force.

A cynic might say that we are moving from a zero defect approach to a zero effect approach. Yet, we can note several basic developments in a Clinton Administration which are close to certainty:

1. A far more activist federal government
2. Much more government regulation
3. Substantially higher business and upper bracket taxation
4. Many more government spending programs, especially in financing and acquiring goods and physical assets
5. On balance, however, far less change than promised in the Governor's economic plan, *Putting People First*. The difficulty in getting a host of programs enacted in a short period of time will force some priorities to be set. Even if the budget restraint were not a pressure, there are practical limits to how many new activities the federal government can undertake in a given period of time.

Another apparent shift in the incoming Clinton Administration will be the rediscovery of fiscal policy as a key lever to influence the performance of the American economy. Simultaneously, the Federal Reserve's monetary policy may well take a back seat, at least for a

while. In contrast to all the talk about job-creating spending activities, the formal Clinton economic program is almost devoid of any attention to monetary policy. Despite the new label (infrastructure), old-fashioned pump priming fiscal policy is coming back in style.

It is unlikely that the new White House will look to any substantial amount of additional monetary ease to stimulate the economy. Of course, down the road, if and when financial markets begin to react adversely to the fiscal stimulus that now seems likely, Alan Greenspan and his colleagues will return to the limelight. Their various terms of office have years to go so that they will continue to be important players on the Washington scene.

In any event, the focus of the national debate on economic policy will shift back from private initiative to government responding to the various problems that attract public attention from time to time. Early on in the new administration, the prospects of a larger public sector may stimulate the now sluggish national economy — provided that financial markets do not blow the whistle on these extremely ambitious plans.

We can recall the experience of M. Mitterand, when he took office in Paris over a decade ago. His proposals frightened world markets. The franc plummeted and financial capital began an exodus from France. The resulting negative feedback forced Mr. Mitterand to slow down or abandon many of his plans to nationalize industry and to expand public-sector activities. We saw some preliminary signs of this phenomenon during the late stages of the election campaign. Long-term interest rates bounced upward in October when new polls confirmed the likelihood of a Clinton victory.

Although it is unlikely, and perhaps undesirable, for the Clinton appointees to ape the various Reagan-Bush actions, there was one modest move that bears repeating. Very early in his Administration, President Reagan and his key economic and financial appointees met with Paul Volcker, the Fed chairman at the time. When we returned to the White House, I quickly reported to the press room on that initial encounter, especially noting that the President opened the meeting by emphasizing the importance of an independent Federal Reserve. A January 1993 meeting like that would help reassure financial markets.

It seems that, for the next four years, we can expect more economic decision making to be made in Washington and probably the adoption of a national industrial and planning policy — with a new label yet to be devised. But perhaps the most important changes will be made in response to developments that are not now visible in anyone's crystal ball.